

# SA Local Government Sector

## Financial Indicators Report

September 2018

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## 1. Introduction

In order to provide an understanding of the current financial position of the local government sector in South Australia, the LGA has undertaken analysis of the most recent SA Local Government Grants Commission Database Reports 2016-17.

This report highlights the very sound financial performance and position of the local government sector as a whole. The evidence shows that South Australian local government is living within its means, has a very low level of indebtedness, and generally is managing its assets satisfactorily. In 2016-17:

- the sector's **operating surplus ratio** was 3.7 per cent – showing that existing levels of income are more than sufficient to cover day-to-day spending. Overall, the sector's income exceeded operating expenses by \$85 million;
- the sector's **net financial liabilities ratio** was 25 per cent – showing that the net amount owed to others is only a modest portion of one-year's income. The sector's net amount owed to others of \$575 million at 30 June 2017 is very low when put in the context of infrastructure and other physical assets valued at \$23.0 billion. It is comparable to a family living in a \$400,000 house having a mortgage of only \$10,000 and no other debts; and
- there were substantial variations in the **asset sustainability ratio** recorded by individual councils. While most councils are renewing and replacing their assets in either a satisfactory or optimal way, there are some councils that could improve on the capital spending needed to cost-effectively maintain affordable service levels from their assets.

## 2. Efficiency of local government

The local government sector in South Australia has an aspiration to be the most efficient sector of government. Sustaining good financial and asset management practices and seeking to continually enhance them are critical success factors for councils as they continue to improve the services they provide to their local communities.

South Australian councils collectively manage an annual budget in excess of \$2.2 billion and maintain infrastructure and other physical assets worth \$23 billion.

Taxation revenue raised by councils (from general and other rates on property) is estimated to be \$1,690 million in 2016-17. Together with other own-source funding (mainly user and statutory charges), approximately 86 per cent of local government operating revenue is from its own sources. The remaining revenue comes from grants from state and federal governments. The rates collected by councils nationally are less than 4 per cent of the total taxes paid by Australians.

South Australian councils manage their finances conservatively under extreme constraints. Local government can raise one type of tax (council rates), has very low indebtedness, receives the lowest per capita state government funding in the nation, and is relying on an extension of the Supplementary Local Roads Program to ensure a fair share of federal government funding.

Cost shifting from State to local government continues to apply pressure to council budgets. Key cost shifting pressures include the mandatory rate rebates that are provided to SA Housing Trust properties transferred to Community Housing Providers, the Solid Waste Levy (which increased by a further 15% in 2018/19), and collection of the State's NRM Levy by councils.

Within this context, South Australian councils are doing a lot with a little and often providing an increasing range of services to a high standard, often with increased levels of financial sustainability.

### 3. Local government financial sustainability

The Local Government Association (LGA) worked with South Australian councils and the state government on a comprehensive Financial Sustainability Program to implement the recommendations of the *2005 Independent Inquiry into Financial Sustainability of Local Government in South Australia*<sup>1</sup>.

This report delivers on one of the Inquiry's recommendations that the LGA reports to each Annual General Meeting on the latest values, history and comparisons of key financial sustainability indicators for the sector as a whole.

Reform of financial management practices within local government in South Australia is ongoing. Changes have included increased scrutiny by the community, an expectation to do more with less, accrual accounting, improved management of infrastructure and other assets, planned performance measurement and benchmarking, and better internal controls and governance arrangements.

A key objective for local government is the achievement and maintenance of the financial sustainability of South Australian councils, both collectively and individually. A council's long-term financial performance and position is sustainable where planned long-term service and infrastructure levels and standards are met without unplanned increases in rates or disruptive cuts to services.

#### *Financial Sustainability Program*

Under its Financial Sustainability Program from 2006 to 2017, the LGA:-

- prepared and updated a comprehensive series of information papers;
- implemented projects to assist councils with financial and asset management reforms;
- undertook training and briefing programs to further assist councils;
- attracted Federal Government funding to further the financial sustainability reforms that were undertaken by South Australian councils; and
- entered into an alliance with the Institute of Public Works Engineering Australia to adopt internationally recognised approaches for preparing asset management policies and plans.

More information about the Program and resources for councils can be found on the LGA's Financial Sustainability Program webpage [www.lga.sa.gov.au/FSP](http://www.lga.sa.gov.au/FSP)

<sup>1</sup> <http://www.lga.sa.gov.au/fsp>

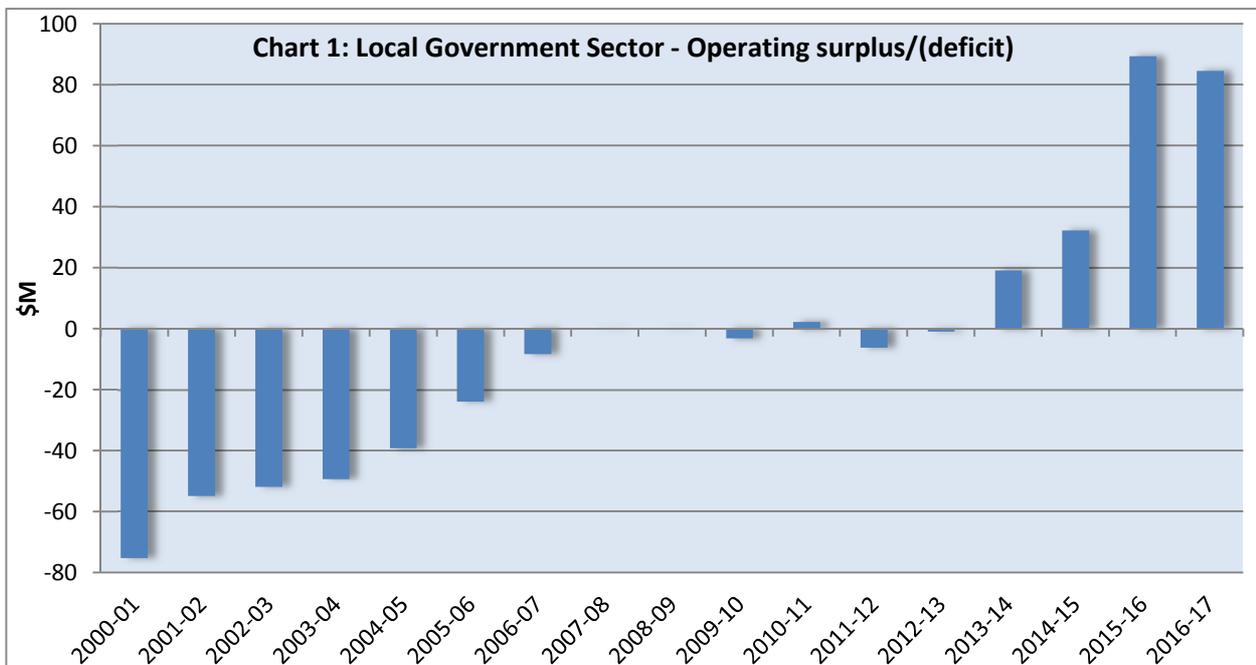
#### 4. Measuring Financial Performance

The most critical measure of local government financial performance is the annual operating result which measures the difference between day-to-day income and expenses for a financial year.

The aggregate level of local government’s annual operating deficit reduced steadily from 2000-01 (when expenses exceeded income by \$75 million) until 2007-08 (when the operating deficit was eliminated). Subsequently, an approximate ‘break-even’ operating result was recorded for five years up until 2012-13. Since then, there has been a significant improvement in the financial performance of councils, culminating in an operating surplus of \$85 million in 2016-17.

A total of 44 councils recorded an operating surplus in 2016-17 compared with only 16 councils in 2000-01.

**Chart 1** provides aggregate data from 2000-01 until 2016-17 covering the sector’s operating surplus/(deficit). The data has been adjusted to remove the distortion otherwise caused by the irregular timing of receipt of Federal financial assistance grants received in some years since 2008-09.

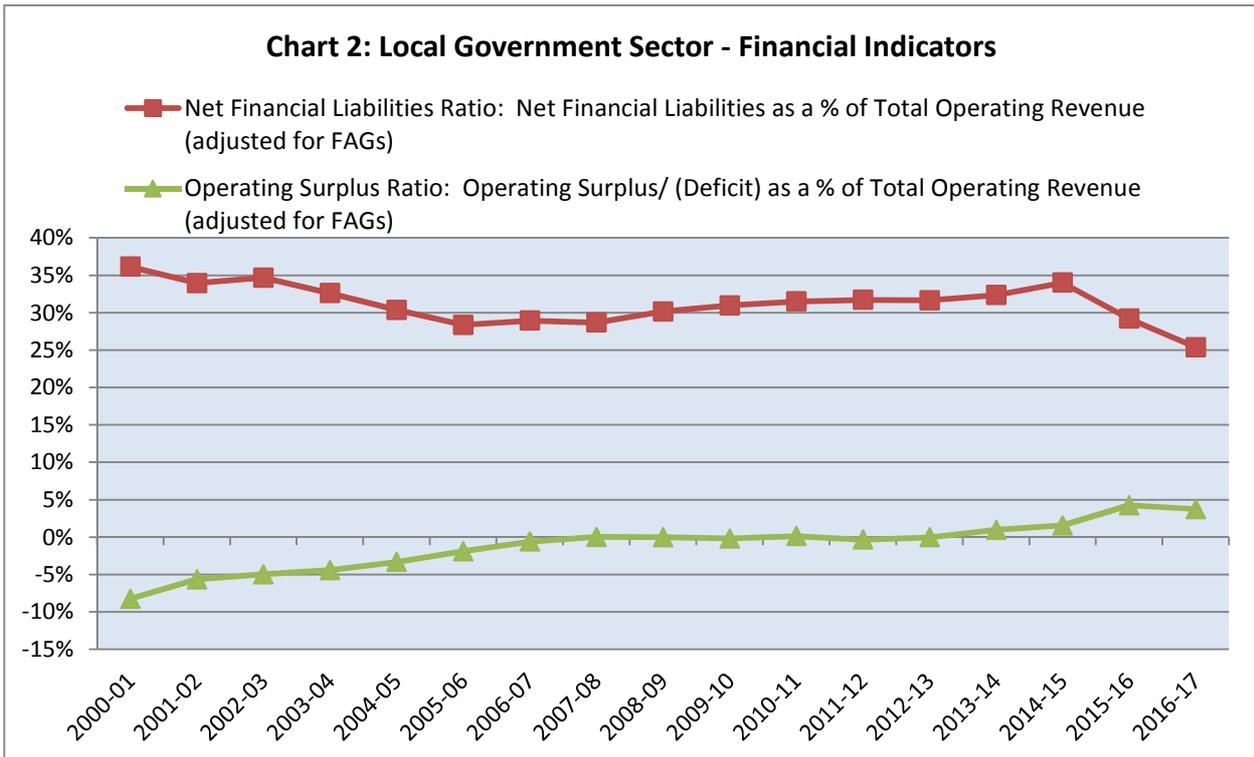


#### 5. Financial Indicators

The following information provides an update on the latest values, history and comparisons of key financial indicators for the local government sector as a whole. The LGA appreciates the assistance of the SA Local Government Grants Commission in providing this data.

In 2006, local government in South Australia adopted two key indicators covering the financial performance (operating surplus ratio) and financial position (net financial liabilities ratio) of the sector.

**Chart 2** provides aggregate data from 2000-01 until 2016-17 for these two indicators. Again, the data has been adjusted to remove the distortion otherwise caused by the irregular timing of receipt of Federal financial assistance grants.



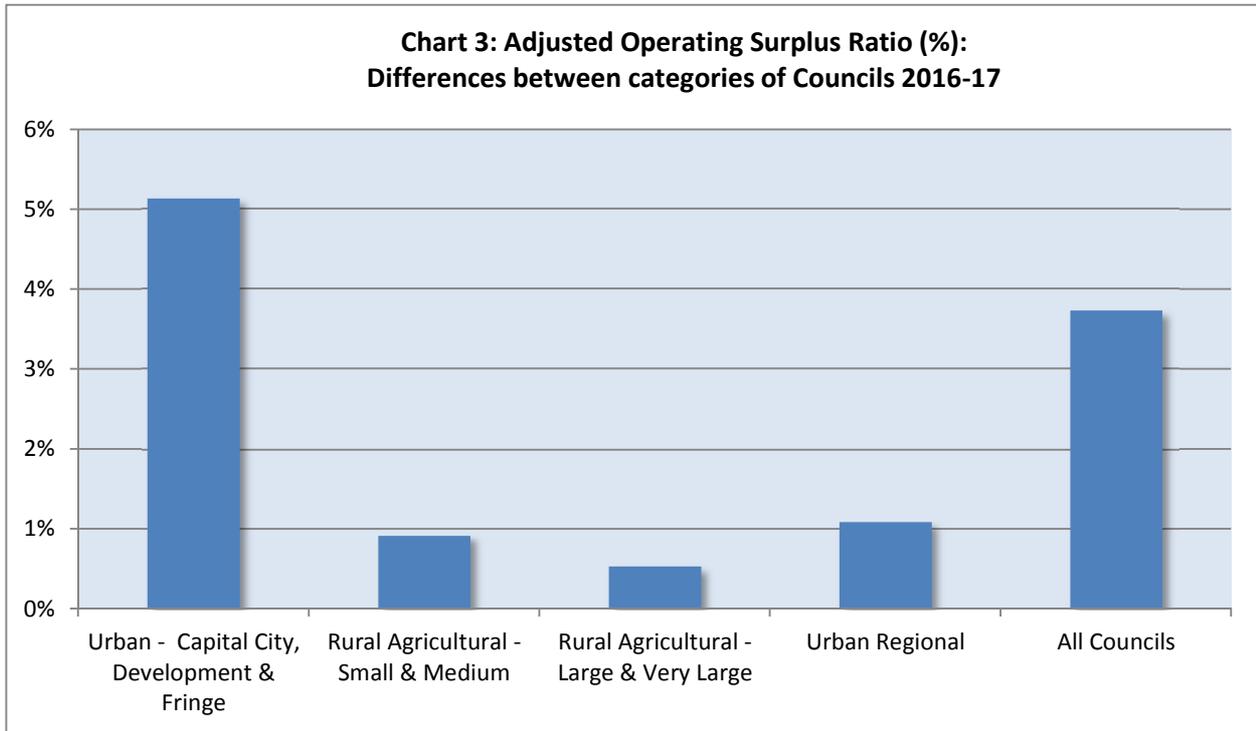
### Indicator 1: Operating Surplus Ratio

The operating surplus ratio is calculated as the percentage by which the annual operating surplus or deficit varies from total income.

Guidance material provided to councils under the LGA's Financial Sustainability Program suggests that councils generally should seek to achieve, on average over time, a target range for an operating surplus ratio of between 0 per cent and 10 per cent.

As shown in **Chart 2** above, the local government sector's operating surplus ratio in 2016-17 was 3.7 per cent. This result compares with an operating surplus ratio of negative 8.3 per cent in 2000-01 and represents a very significant improvement in the financial sustainability of councils over a 16 year period.

**Chart 3** shows the differences in the operating surplus ratios between categories of councils recorded in 2016-17.



### Indicator 2: Net Financial Liabilities Ratio

Net financial liabilities represent the amount of money owed by councils to others less money held, invested or owed to councils. It is the most comprehensive measure of the indebtedness of a council as it includes items such as employee long service leave entitlements and other amounts payable as well as taking account of the level of a council's cash and investments.

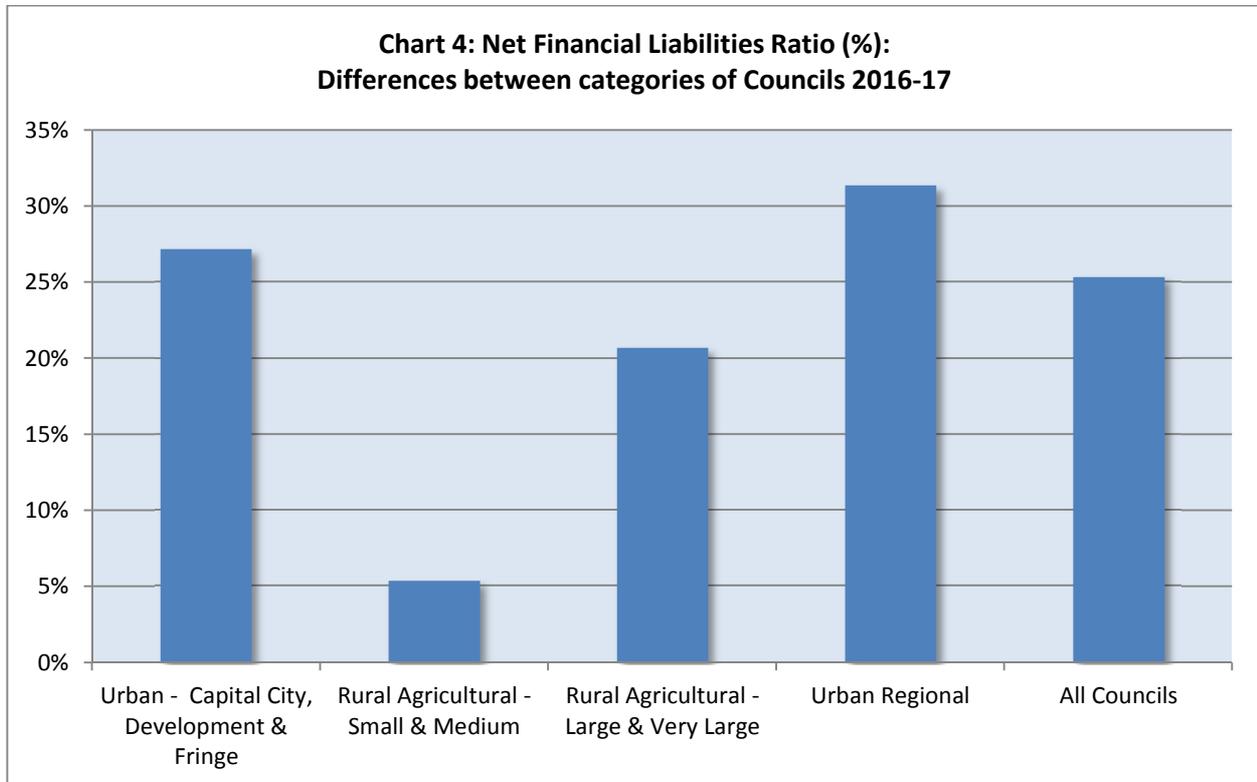
At 30 June 2017, the level of net financial liabilities was \$575 million. This is very low when put in the context of local government infrastructure and other physical assets valued at \$23.0 billion.

The net financial liabilities ratio is a measure of the significance of the net amount owed at the end of a financial year compared with income for the year.

As shown in Chart 2 (on the previous page), the net financial liabilities ratio for the local government sector in 2016-17 was 25 per cent which compares favourably with a figure of 36 per cent in 2000-01.

Net interest payments associated with councils' net financial liabilities were \$22.0 million in 2016-17. This represents 1.0 per cent of total operating expenses – a further reinforcement that, in aggregate terms, local government indebtedness is very low. It also is worth noting that the level of net financial liabilities shown above does not take account of accumulated surpluses in the LGFA and the LGA 'Schemes'. These accumulated surpluses were well in excess of \$100 million at 30 June 2017 and represent financial assets belonging to the local government sector in South Australia.

**Chart 4** shows the differences in the net financial liabilities ratios between categories of councils recorded in 2016-17. The chart highlights that many small and medium size rural councils are adverse to incurring debt to help finance the cost of infrastructure and other assets.



Provided operating deficits are avoided, there appears to be considerable scope for some councils to increase their level of borrowings (or liquidate some of their large stock of cash and investments, which is equivalent to borrowing) to finance capital expenditure. Such borrowings could be undertaken for renewal or replacement of existing assets where a council's Infrastructure and Asset Management Plan suggests that it is optimal to do so.

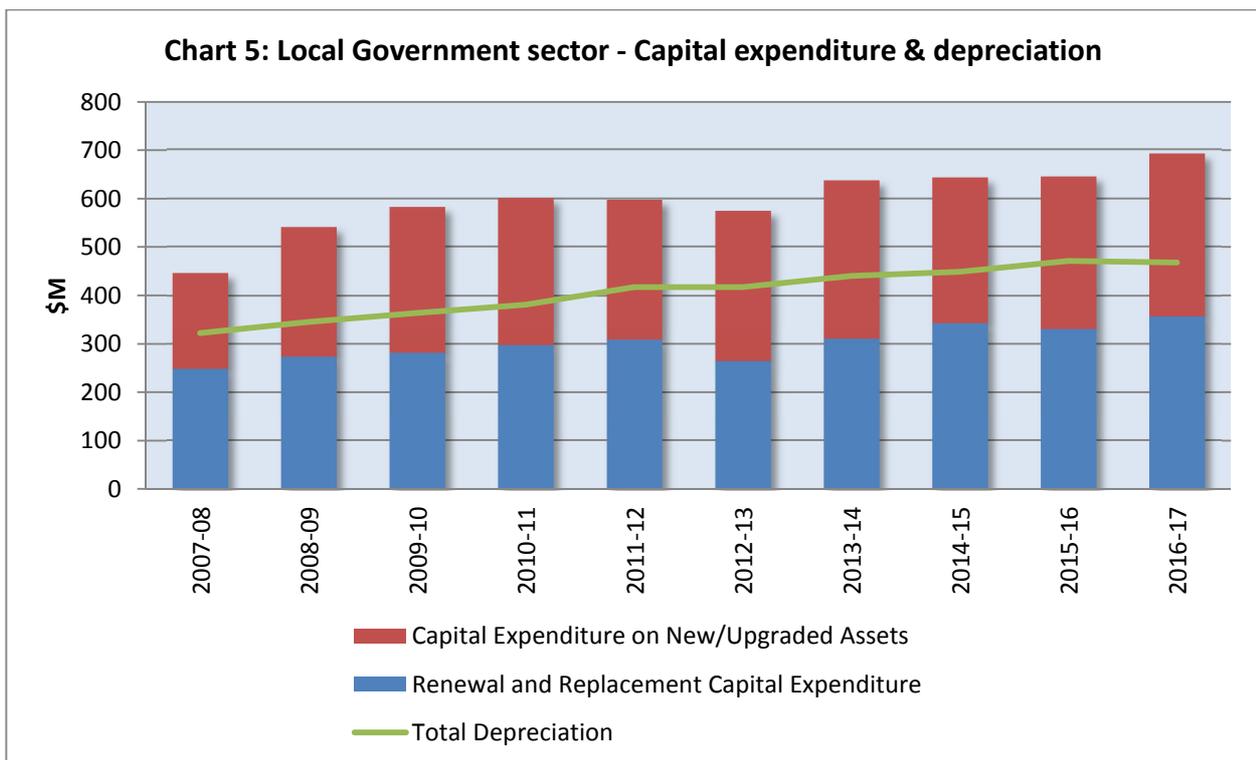
Where a council is not achieving an underlying operating surplus, or trending towards doing so in the medium term, then generally any capital expenditure on upgrading or expanding infrastructure needs to be modest and targeted, because it normally will lead to additional maintenance and depreciation costs.

### Capital Investment Expenditure

Overall, capital expenditure in 2016-17 was a record high \$692 million.

One of the findings of the abovementioned *2005 Independent Inquiry into Financial Sustainability of Local Government* was that capital investment expenditure on renewal and replacement of existing assets was significantly less than that needed to minimise whole-of-life-cycle costs of assets.

**Chart 5** shows the level of capital expenditure over the past ten years on renewal/replacement of existing assets on one hand and expenditure on new/upgraded assets on the other. This shows an increased expenditure on renewing and replacing existing assets in most years.



### Indicator 3: Asset Sustainability Ratio

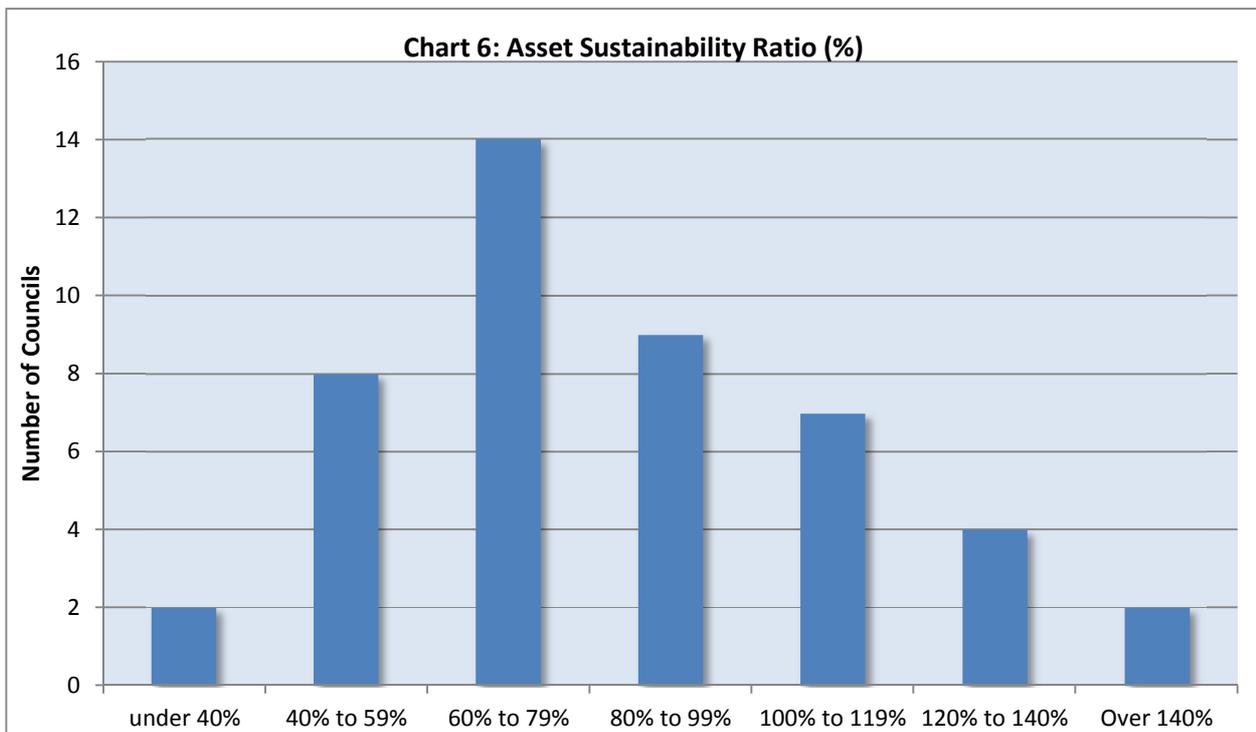
A third financial indicator adopted by the sector in recent years covers the asset management performance of councils. The asset sustainability ratio represents the level of capital expenditure on renewal and replacement of assets relative to the level of such expenditure identified as warranted in a council's infrastructure and asset management plan.

This indicator is a measure of whether a council is accommodating asset renewal and replacement in an optimal and cost effective way from a timing perspective, relative to the risk it is prepared to accept and the service levels it wishes to maintain.

There are operational and other reasons why the asset sustainability ratio result may vary between years. This may not necessarily detract from asset management performance if a council's target is achieved over the medium term (e.g. over a rolling 3 or 5 year average).

Data on an asset management performance indicator is available for 46 councils in 2016-17.

**Chart 6** provides summary information for the asset sustainability ratio in 2016-17. Of the 46 councils for which data on an asset sustainability ratio is available, 78 per cent of councils had a ratio higher than 60 per cent.



### **A note on the differing financial performance of councils**

This report demonstrates significant improvement over the past 16 years in the financial performance and financial position of the sector as a whole.

However, it needs to be emphasised that the current financial condition of individual councils varies substantially.

In addition, in the absence at this stage of reliable data covering asset management performance in some, mainly rural, councils, it is not possible for those councils to quantify the extent of any annual shortfalls against the optimal level of capital expenditure on renewal and replacement of existing assets to provide desired and affordable service levels.